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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

RATE ADJUSTMENT DUE TO EXTRAORDINARY OR EXCEPTIONAL CIRCUMSTANCES	)))))	Docket No. R2013-11R

VALPAK DIRECT MARKETING SYSTEMS, INC. AND VALPAK DEALERS' ASSOCIATION, INC. REPLY COMMENTS IN RESPONSE TO ORDER NO. 2540
(July 6, 2015)

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (hereinafter "Valpak") submitted Initial Comments on June 26, 2015, and hereby submit these Reply Comments in response to Commission Order No. 2540, primarily responding to the Initial Comments of the U.S. Postal Service, but briefly addressing Initial Comments of other parties as well.

I. U.S. Postal Service Initial Comments

A. Scope of Case on Remand

After the Court's decision, the Postal Service's original Motion seeking the commencements of remand proceedings (June 8, 2015) proposed a new way to estimate volume lost due to the recession. It suggested "a correction of the 'count once' flaw," contending that it was "not difficult to quantify" the money to which the Postal Service was entitled. *Id.* at 2, 5. Although the Postal Service also implied that there was a need for "consideration of the full range of issues" on remand, the Postal Service made only one specific proposal in its Motion. *Id.* at 7. Responding to the Postal Service Motion, Commission Order No. 2540 invited comment "on the Postal Service's methodological approach for accounting for volume losses due to the Great Recession in a cumulative manner and any other relevant issues they [the commenters] wish to address." *Id.* at 7.

Section III.A of the Postal Service's Initial Comments purport to address the same "simple set of computations" for the Postal Service's proposed correction of the "count once" rule (*id.* at 2), but in truth, they go far beyond that simple correction, including proposals to reconsider aspects of Order No. 1926 that have already been affirmed by the Court of Appeals. With the Court having found "new normal" and other aspects of Order No. 1926 to be reasonable, a remand limited only to the issue of how many times to count lost volumes already identified as due to the recession is the only issue the Court required the Commission to address. Valpak believes it is the only issue that should be now considered.

There is one other aspect of the Court's decision that deserves separate comment, because the Postal Service has tried to make much of it in its Initial Comments. The Court of Appeals expressly noted that the Commission was "free to consider" an argument that the Postal Service belatedly raised during oral argument, "that the 'new normal' analysis in the Order is also inconsistent with the Commission's analysis of whether the rate increase was 'necessary.'" Slip op. at 17 n.3. The Postal Service's Initial Comments attempt to transform the Court's comment about a late-raised issue into a virtual mandate to the Commission: "the court explicitly invit[ing] the Commission to revisit the issue." Postal Service Initial Comments at 7. However, as the Court stated, the Postal Service had failed to raise this issue either before the Commission, or in its briefs,[1] raising it only "belatedly ... during oral

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[1] In its Initial Comments, the Postal Service seems to have backed off of the position in its June 8 Motion that it had presented the issue of inconsistency fully and clearly in

argument." It should be clear that, because the Court viewed the Postal Service's argument as not having been properly raised on appeal, the Court never ruled on that issue. Accordingly, the Commission is under no obligation to give the Postal Service another opportunity to find a basis for prolonging exigent rates.[2] Should the Commission decide to reopen the record on this new Postal Service issue, it should provide a separate opportunity for comment on that issue.

B. Eradication of the Count Once Rule

In its Initial Comments, the Postal Service argues, as is it did in its June 8 Motion, that elimination — or "eradication" — of the "count once" rule leads to the simple conclusion that the Commission must count all mail volume lost due to the recession cumulatively. *See* Postal Service Initial Comments at 5-7.

The Commission understood the Postal Service's cumulative proposal, and properly rejected it. In Order No. 1926, the Commission explained:

> The Commission's responsibility in this case entails determining the Postal Service's total mail volume loss due to the Great Recession. Thus, the Commission must decide **how many times it is appropriate to count volume lost in a prior year** due to the Great Recession that continues to be lost in subsequent years. Put another way, in calculating the volume losses due to the Great Recession, the Commission must determine whether to count pieces lost once, as lost again every year until volumes rebound. [*Id.* at 95 (emphasis added).]

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its briefs. *See* Postal Service Motion at 4 n.3 and Initial Comments at 5 n.9.

[2] PostCom, *et al.* Initial Comments also explain that "The Postal Service's expansive reading of the scope of the remanded proceedings contemplated by the D.C. Circuit opinion is refuted by the court's opinion." *Id.* at 9.

The Court of Appeals did not reverse the Commission because it preferred the Postal Service's cumulative-counting argument, but instead simply held that "count once" was arbitrary and insupportable on the record. Slip op. at 15-17. Nowhere in its decision did the Court of Appeals adopt, embrace, or endorse the Postal Service's cumulative counting methodology. On the contrary, the Court implicitly affirmed the Commission's decision to cut off the unlimited cumulative counting of lost volume at some point: "The 'new normal' rule also demonstrates that it is entirely possible … to **identify a stopping point** for the recession's exigent impact on lost mail volume." Slip op. at 16 (emphasis added). The Court said that "new normal"-type "considerations, rather than a mechanical tally of the time passed since the recession, could not guide the Commission's determination of **when to stop counting** lost mail volume." *Id*. at 17 (emphasis added). The Postal Service's proposal of "when to stop counting" in the original exigent case is simply: "don't." It woodenly applied its own mechanical tally, not suggesting any limiting principles to guide the Commission's determination.

With respect to the limit placed on recovery based on the exigent circumstances, the Commission stated: "Once impact of a circumstance is normal, and the Postal Service has begun to adjust to it, additional impact cannot be said to be due to a past extraordinary or exceptional circumstance." Order No. 1926 at 94. The same analysis applies to counting of prior year losses in subsequent years.

Now, after the remand, the Postal Service has dramatically modified its demand, reducing it from infinity to $11.4 billion. Until June 26, the Postal Service position was that it could never adjust to the new normal, and the Commission was obligated to provide it additional revenue for 20 years, or more. *See* Cross Examination of Witness Thress, Tr. 1/103-04. Valpak has never believed that the Postal Service was unwilling or unable to cut costs to adjust to the new normal volume levels. In multiple dockets, Valpak has regularly supported Postal Service-initiated cost cutting. *See, e.g.,* Docket No. N2012-1, Valpak Initial Brief at 3-10 (July 10, 2012). What Valpak opposes is having the Postal Service collect above-CPI cap revenues to pay for (i) expenses that it had cut, or (ii) should have cut (*e.g.,* expensive door delivery for grandfathered-in neighborhoods), or (iii) money that it chose to give away to mailers by charging rates which did not even cover attributable costs (*e.g.,* Standard Flats).

In its Initial Comments, Valpak set out Tables 1 and 2 to demonstrate the degree to which the Postal Service has had success in cutting costs by reducing its workforce to adjust to reduced volume. In these Reply Comments, Valpak draws on that work to provide the Commission with a method to evaluate — and, indeed, calculate — exactly how successful the Postal Service was in adjusting to decreased volume by year. This information is presented in Valpak Table 1, entitled "**Postal Service Adjustment to Reduced Volumes**" (attached hereto).

> **Part A** of Table 1 provides a method for counting volume lost in subsequent, continuing years which can be considered due to the recession. But as labor represents about 80 percent of the Postal Service's annual operating costs, any meaningful reduction in costs and adjustment of operations are reflected in the number of employees. Part A reports the number of career and non-career employees as reported annually in the Form 10-K reports, demonstrating that the Postal Service has taken great strides to adjust its workforce to the new normal. Moreover, the Postal Service

also had ongoing efforts to reduce costs in ways other than reducing employee headcount, including, for example[3]:

- Reduction in overtime hours;
- Reduction in transportation costs;
- Limits on spending for supplies, services, travel, and other discretionary items; and
- Adjusting the size of its plant and network.

Rather than rely on the Postal Service to quantify all of the cost-reducing items, the number of **total employees**, shown in Part A, column 3 can be used as a reasonable proxy for all of the Postal Service's cost-reduction efforts.

Part B of Table 1 uses the number of employees in 2007, before the start of the recession, as a base for what might be described as the "old normal," and then computes the number of employees in subsequent years as a percentage of the 2007 base. The official end of the recession (according the National Bureau of Economic Research) occurred in June 2009, but at that time the new normal was reached only for Standard Mail and Package Services. By 2011 the total number of employees had begun to level out, reflecting only the gradual change in the volume of mail. In 2012, the number of career employees continued declining while the number of non-career employees actually **increased** sharply. This was a good indication that, **by the end of**

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[3] *See* 2009 Report on Form 10-K, p. 12.

2011, postal operations had fully transitioned from the recession to the "new normal."

Part C of Table 1 shows the total headcount reduction from 2007 to the year indicated. As can be seen from column 3, between 2007 and 2011 the total number of postal employees declined by almost 140,000.

Part D of Table 1 shows the cumulative reduction in the number of employees as a percentage of the total reduction achieved by 2011. For instance, by 2008, the reduction in the total number of employees (20,841; Part C) was only 15 percent of the total 139,979 reduction achieved by 2011. This low percentage reflects the Postal Service's inability to reduce costs quickly "in response to the massive volume declines." However, by 2009, the Postal Service had reduced the total number of employees by 73,847, which was **52.8 percent** of the total 140,000 reduction achieved by the time the new normal was reached in 2011. In other words, by 2009, the Postal Service had yet to achieve the remaining **47.2 percent** of the total reduction of 140,000 employees.

With the passage of time, the Postal Service continued to adjust its operations to the new normal.

- By the second year, it was **52.8 percent** of the way there, with an adjustment yet to be made of 47.2 percent.
- By the third year, the adjustment of operations was **74.5 percent** toward the full adjustment, leaving only a 25.5 percent adjustment remaining.

- By the fourth year, Postal Service workforce had **fully adjusted** to the new normal.

The weights are used to discount the volume in second and subsequent years to reflect the extent of the adjustment to the new normal, instead of the ongoing mechanical count proposed by the Postal Service. The attached Table 2, Adjusted Estimate of Lost Volume Due to Great Recession, shows that discounting subsequent year volumes to adjustments in operations results in lost volume due to the recession of 29.624 billion pieces, up from the 25 billion pieces originally calculated by the Commission's count once rule.

In lieu of using total **employees** as a proxy for the extent of Postal Service adjustment to the recession, the Commission might believe that it is more appropriate to use the total number of **workhours** (as shown on page 34 of the 2012 Form 10-K) as such a proxy. Use of workhours rather than employees would actually reduce the adjustment factors in 2009 and 2010, from 47.2 and 24.5 percent, to 39.8 and 13.4 percent, respectively. Although the Postal Service would doubtless prefer to have the Commission use total employee numbers, Valpak leaves this matter up to the Commission.

It is interesting that the Court's remand has required all parties to think through these complicated issues once more and refine their positions. In refining its position, the Postal Service has reduced its demand from infinity to $11.4 billion as discussed in Subsection C, *infra*. Indeed, the Postal Service is correct when it contends that it was not able to adjust immediately to reduced volume levels. As demonstrated by comparing total employees or total workhours, it becomes clear that adjusting to the new normal did not happen all at once. However, the Postal Service is not correct when it seeks to divert attention from the fact that it was able to cut, and in fact was cutting, costs as aggressively as allowed by its labor pacts. As it should have done, the Postal Service was in fact making adjustments toward the new normal, and while it could and should be criticized for not having done more (such as aggressively reducing door delivery), it did a great deal. The Commission's task on remand is to determine "when to stop counting lost mail volume," and the data presented herein by Valpak presents an objective framework for the Commission that would inform its determination in an expert, non-mechanical fashion.[4]

C. Extending Exigent Recovery until FY 2013

In its Initial Comments, the Postal Service takes the position that the Commission should extend the beginning of the new normal — and thus the period for counting volumes lost due to the recession — until the end of FY 2013.[5] *See* Postal Service Initial Comments at 7-21. The Postal Service's entire argument for extending the cut-off date of counting volume loss due to the recession is based on a false premise. The Postal Service begins by identifying a supposed inconsistency in Order No. 1926 because Part IV recognized the Postal Service's ability to adjust to reduced volume, while Part V "recognized the constraints that inhibit the Postal Service's ability to adjust...." Postal Service Initial Comments at 4-5. The Postal Service then redefines "new normal" as referring "to two discrete inquiries": (i) when volume

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[4] This analysis can be used in conjunction with that provided by GCA/NPPC's Initial Comments.

[5] The Postal Service's liquidity already exceeds by several-fold the level that existed in 2006-2007 before the exigent circumstance arose.

declines have stopped[6] and (ii) when the Postal Service was able to adjust its operations to the new volumes. *Id.* at 7-8. Finally, in the largest leap, it boils down the Commission's entire four-element "new normal" analysis into one point: "Taken together, then, the Commission's holding is essentially that the 'new normal' is the point at which Postal Service was able to adjust its operations in response to the shift in the level of mail volume." *Id.*

The Postal Service then spends the next 14 pages discussing if, when, and how it had or did not have the ability to adjust its operations to permanently reduced volumes. It then concluded that it did not regain its ability to adjust until FY 2013, and the Commission should count volume losses due to the recession cumulatively until that time. However, because the premise is false, the Postal Service's entire analysis is flawed.

The Postal Service's argument is flawed because it boils the new normal analysis down to one element, the ability to adjust postal operations to the new volume level. However, Order No. 1926 clearly used four factors as a test to determine the new normal:

> For the Great Recession, the Commission concludes that the "new normal" point in time is when all or most of the following occur: (1) the disruption to a sufficient number of relevant macroeconomic indicators demonstrate a return to near historic positive trends; (2) application of the macroeconomic variables accurately project change, and the rate of change on Postal Service mail volumes is positive; (3) the Postal Service regains its ability to predict or project mail volumes following an extraordinary or exceptional event; and (4) the Postal Service demonstrates an ability to adjust operations to the lower volumes. [*Id.* at 86.]

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[6] The Postal Service relies on several quotations from the Court of Appeals opinion and Order No. 1926 which just happen to use "new normal" in the same sentence as the word "volume." *See* Postal Service Initial Comments at 8 n.18.

The Court of Appeals summarized these four elements (certainly better than the Postal Service did) and specifically determined that the "'new normal' rule was well reasoned and grounded in the evidence before the Commission." Slip op. at 11, 17. The Commission considered the four factors taken together to determine when the new normal began, and the factors cannot be disconnected while maintaining the analysis.

The Postal Service is now ignoring the first three factors and only focusing on the last one. The Postal Service is seeking to reopen the Commission's analysis of when the exigency ended, but only the part that helps it. It is essentially relitigating the new normal analysis, but only in part. Both the attempt to relitigate this issue and the Postal Service's analysis should be rejected.

D. Ending Standard Mail and First-Class Mail at the Same Time

Finding no need to be consistent, the Postal Service argues that First-Class Mail and Standard Mail should have the **same cutoff** for counting volume losses due to the recession. *See* Postal Service Initial Comments at 21-26. Order No. 1926, based on testimony of witness Thress, concluded that the new normal occurred differently for First-Class Mail (FY 2010), Standard Mail (FY 2009), and Periodicals (FY 2011): "As Thress suggests, the new normal may be different for each class of mail." Order No. 1926 at 86. This is part of the new normal analysis which was specifically affirmed by the Court of Appeals.

The Postal Service now wants the same date for all classes based solely on the "ability to adjust" factor of the new normal analysis. It claims that its operational adjustment efforts "reduced costs for all classes of mail moving through the postal network, since First-Class

Mail, Standard Mail, Periodicals, and so forth are all processed in the same facilities and delivered by the same carriers." *Id.* at 24-25.

The Postal Service's inconsistency is made even worse by the fact that, on appeal, one of the Postal Service's primary arguments was that the Commission was arbitrary and capricious because it determined new normal at the class level and not at the less aggregated sub-class level:

> The Commission, however, arbitrarily glossed over those important differences. Rather than providing a granular analysis as USPS had done, the Commission lumped all of the sub-classes together and conducted its "new normal" analysis at the much-broader class level.... Assessing a "new normal" date by class, instead of category, clouds the fact that different sub-classes of mail plateaued at different times ... [b]ut different categories of mail *within* that class reached the "new normal" at different times.... [I]t is baffling that the Commission would not embrace the most precise data available. [Postal Service Petitioner's Brief (Apr. 15, 2014) at 38-40.]

The Court of Appeals determined that "the Commission acted well within its discretion in starting the date of the new normal separately for each class of mail, rather than smaller sub-classes." Slip op. at 14. That should be the end of the matter, and should preclude the Postal Service from again shifting its position to rationalize further exigent revenue.

E. "Reasonable, Necessary, and Equitable"

In order to obtain a rate increase which exceeds CPI, the Postal Service is required to demonstrate that the rates sought are "reasonable, necessary, and equitable." 39 U.S.C. § 3622(d)(2). Valpak contends that, during the period that the Postal Service claims to have been unable to more rapidly adjust to the new normal, the Commission's analysis should not be limited to the Postal Service's success in cost cutting, as discussed in Subsection C, *supra*.

Rather, the Postal Service should be required to demonstrate that it did not squander its resources by deliberately setting prices below cost for its favored products. If the Postal Service used what it views as broad authority to engage in "pricing flexibility" and if the exercise of that power was detrimental to Postal Service finances, the Postal Service should not be permitted to obtain above-CPI revenue increases to compensate it for the losses it chose to incur.

This is not a new issue. In commenting on the Postal Service's exigent rate request, Valpak objected to allowing a recovery for money for the Postal Service to lose on underwater products. Docket No. R2013-11, Valpak Initial Comments at 48-60. This point was expanded upon in Valpak's Reply Comments in that docket at 6-7. Although the Commission did not find this issue persuasive in Order No. 1926, the continuing losses on underwater products demonstrates that the Postal Service's continued abuse of its pricing authority by pricing products below cost adversely affects mailers using all classes of mail who are being required to pay higher, exigent rates. The Postal Service's need for additional revenue is largely due to the fact that it chose to lose $9.75 billion over the past seven years on underwater products. *See* Docket No. ACR2014, Valpak Initial Comments at V-2. Accordingly, it could not be more clearly revealed that the price cap cannot and does not protect any mailers — whether they use Standard Mail or other classes of mail — from paying higher postage due to the Postal Service's continued illegal pricing of products like Standard Flats in violation of 39 U.S.C. § 101(d).

II. American Postal Workers Union, AFL-CIO

The Initial Comments of the American Postal Workers Union ("APWU") begin with a misplaced defense of Acting Chairman Taub's dissent in Order No. 1926. APWU claims that the Court of Appeals' vacating of the "count once" rule vindicates Taub's dissent. However, that dissent was from adoption of the "new normal" test (*see* Taub Dissent at 4) — which was explicitly affirmed by the Court of Appeals — and never explicitly addressed the "count once" rule.

III. Association for Postal Commerce, *et al.*

The Initial Comments of the Association for Postal Commerce, *et al.* ("PostCom, *et al.*") explain that the Commission has used unit contribution data **of the wrong vintage***,* and a recovery of no more than $2.826 billion in cumulative losses is warranted. *Id.* Section I at 3-8. PostCom concludes Section I of its comments with the following statement:

> the Commission should modify Order No. 1926 by authorizing the Postal Service to extend the termination date of the 4.3 percent exigent surcharge by a period long enough to collect $2.826 billion in total contribution instead of $2.766 billion. [*Id.* at 8.]

Valpak agrees with PostCom, *et al.* PostCom, *et al.*'s recommendation would extend the termination date of the surcharge from early August to late August 2015.

Furthermore, PostCom, *et al.* bases its $2.826 billion figure by counting subsequent year volumes lost as proposed by the Postal Service for mechanically eliminating the count once rule. However, if the Commission adopts an adjustment to carryover volume losses along the lines Valpak proposed in Section I, *supra*, then the recoverable contribution will be less than what the Commission originally approved. **The Postal Service is now recovering**

more than is allowed and should be required to submit a 45-day notice of removal of the exigent surcharge as soon as possible.

IV. Greeting Card Association and National Postal Policy Council

The Initial Comments of the Greeting Card Association and National Postal Policy Council ("GCA/NPPC") are based on the same premise as Valpak's comments: that the task of the Commission in this remand proceeding is to develop a reasonable method for calculating volume losses due to the recession. GCA/NPPC notes that "the Court did *not* direct the Commission to approve the type of alternative calculation that the Postal Service presented in its *USPS Motion* — which is a 'count every piece every year' approach." *Id*. at 5-6.

GCA/NPPC presents an approach for determining how to limit the counting of volume lost in one year in subsequent years. GCA/NPPC proposes removing the proportion of lost volume in subsequent years that would have been lost for other reasons. This is an important additional factor for the Commission to evaluate in determining how much volume was lost due to the recession.

V. The National Association of Letter Carriers, AFL-CIO

The National Association of Letter Carriers ("NALC") claims that the Court of Appeals "indicated that the Commission was 'free to consider' on remand USPS's argument that the Commission's 'new normal' analysis underestimated USPS's losses due to the Great Recession." *Id*. at 2. Valpak submits that such a claim reflects a misunderstanding of the Court's language in footnote 3. *See* Valpak Initial Comments at 8-9.

NALC submits a brief summary of an attached study ("Price Cap Regulation and Declining Demand") for the purpose of reconsidering the "new normal" analysis "to allow

USPS to recoup more in exigent surcharges...." NALC appears to conflate the price cap with recovery of revenue under extraordinary or exceptional circumstances. The Postal Service is not seeking an adjustment of any kind to the price cap, while NALC's study is primarily about adjusting the price cap to account for decreased economies in a declining demand market.[7] It is therefore irrelevant to these proceedings.

VI. The Public Representative

The Public Representative's Initial Comments properly reject the Postal Service's proposal: "The Public Representative also believes that estimating the exigency loss by factoring in the cumulative mail piece loss until the new normal is reached, as implied by the Court, is equally arbitrary and capricious." *Id.* at 2. Valpak agrees with the PR that "focusing on [any] timeframe to mechanically count lost mail pieces will not lead to a meaningful estimate of the amount that the Postal Service should be allowed to recover due to the exigent circumstance." *Id.*

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[7] Furthermore, the price cap is established by 39 U.S.C. § 3622(d)(1)(A) to be "equal to the change in the Consumer Price Index...." There is no provision for adjustment to the price cap itself.

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